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No. 1471

In the
Supreme Court of the United States

OCTOBER TERM, 1970

C. A. SAMMONS, Individually and as Independent Executor of the Estate of ROSINE S. SAMMONS, Deceased,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

WHITE, McELROY & WHITE,
B. THOMAS McELROY,
2505 Republic National Bank Tower,
Dallas, Texas 75201,
Attorneys for Petitioner.

THE WARLICK PRESS DIVISION, STECK-WARLICK CO.
P. O. BOX 10543 — 1455 ROUND TABLE DRIVE — DALLAS — 631-3130

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No. .....

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UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioner prays that a Writ of Certiorari issue to review the Judgment of the United States Court of Appeals for the Fifth Circuit, entered in the above entitled case on November 4, 1970.

CITATION TO OPINION BELOW

The Opinion of the Court of Civil Appeals for the Fifth Circuit, printed in Appendix "A" herein, is reported in 433 Fed. 2d 728.

JURISDICTION

The Judgment of the Circuit Court of Appeals was entered on November 4, 1970. Rehearing was denied on December 15, 1970. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the Circuit Court was correct in holding that intent to distribute corporate earnings is not a requirement for a finding that a constructive dividend has been paid, and that therefore Taxpayer-Petitioner has an erroneous view of this Honorable Court's Decision in *Palmer v. Commissioner*, 302 U.S. 63, 69 (1937).

STATUTES INVOLVED

The statutory provisions herein involved are Sections 316(a) and 301(c)(1) of the Internal Revenue Code of 1954, defining "dividends" to shareholders and requiring inclusion in gross income of corporate distributions which *are* dividends. These provisions of the Code are set forth in footnote 2 to the Circuit Court's Opinion.

STATEMENT

The jurisdiction of the District Court was invoked because, in this Federal income tax refund case, arising under the Internal Revenue Code of 1954, Petitioner, on October 21, 1963, paid to the District Director the claimed deficiency in

his 1958 Federal income tax return in the amount of $178,369 in Federal income taxes and $48,323 in assessed interest thereon, and thereafter Petitioner filed a claim for refund for the deficiency and interest he had paid, plus interest, which claim was disallowed.

This was a constructive dividend case tried by District Judge Sarah T. Hughes before a jury. Submission of the cause was made to the jury upon two interrogatories as follows:

> Special Issue No. 1
>
> Do you find from a preponderance of the evidence that the stock of Texas Fulton and/or the interests of American Republic in the manufacturing plants in New Orleans and St. Louis were sold to Fidelity National Life Insurance Company for substantially less than the fair market value thereof?
>
> Answer: Yes
>
> Special Issue No. 2
>
> From a preponderance of the evidence, for how much less, if any, than the fair market value was the Fulton stock and/or the interests in the plants in New Orleans and St. Louis sold to Fidelity National Life Insurance Company?
>
> Answer: $500,000

At the trial level prior to submission of the Court's Charge to the jury Petitioner duly filed his requested instruction number one providing in its relevant part as follows:

> "A sale by a corporation of its property made, directly or indirectly, to a shareholder thereof at a sales price substantially less than the fair market value of

> such property at the time of such sale will result in a distribution, actual or constructive, to such shareholder *if such sale was in purpose or effect used and intended as an implement for a distribution to such shareholder.*" (Emphasis added)

Further, at the trial level prior to submission of the Court's Charge, Plaintiff submitted his requested special issue number five, as follows:

> "Do you find from a preponderance of the evidence that the transactions inquired about in special issue number one and number three, or either of them, were in purpose or effect used and intended as implements for the distribution of the dividend to the individual Plaintiff C. A. Sammons?
>
> Answer Yes or No."

After the first draft of the Court's Charge, special issues number one and three were combined by the Trial Court into one special issue, as shown above, inquiring as to the fair market value of both the Texas Fulton shares and of the fixed assets reversion sold by American Republic Life Insurance Company.

Then both Petitioner's requested instruction and Petitioner's requested special issue number five set out hereinabove were refused, and after the jury verdict above referred to was returned the Trial Court entered the Judgment from which appeal was subsequently made.

The United States Court of Appeals, in affirming the decision of the District Court, has stated that Taxpayer has urged an erroneous view of *Palmer v. Commissioner*, supra, because "Intent to distribute corporate earnings is not a

universal requirement for a finding that a constructive dividend has been paid."

In support of its position the Circuit Court of Appeals cited *Waldheim v. Commissioner*, 244 F. 2d 1 (C.A. 7, 1957) and *Commissioner v. Gordon*, 391 U.S. 83 (1968). But the *Waldheim* case merely cites *Palmer* for the principle that in the absence of an *intent* to distribute a dividend on the part of a corporation a distribution of corporate assets may or may not be taxable as a dividend *according to the circumstances of the transaction.* The *Gordon* case discusses the *Palmer* case in a footnote but not on the question of intent, and in the body of the case the issue here in controversy does not appear to have been directly considered.

REASONS FOR GRANTING THE WRIT

The decision of the Court of Appeals in the instant case is in conflict with *Palmer v. Commissioner*, supra. The pertinent part of *Palmer* is as follows:

> "On the other hand, such a sale, if for substantially less than the value of the property sold, may be as effective a means of distributing profits among stockholders as the formal declaration of a dividend. The necessary consequence of the corporate action may be in substance the kind of a distribution to stockholders which it is the purpose of Section 115 to tax as present income to stockholders, and such a transaction may appropriately be deemed in effect the declaration of a dividend, taxable to the extent that the value of the distributed property exceeds the stipulated price. *But the bare fact that a transaction, on its face a sale, has resulted in a distribution of some of the corporate assets*

to stockholders, gives rise to no inference that the distribution is a dividend within the meaning of Section 115. To transfer it from the one category to the other, it is at least necessary to make some showing that the transaction is in purpose or effect used as an implement for the distribution of corporate earnings to stockholders."

The holding in *Palmer* is clearly correct, but there is a great danger today of erosion of the principle there announced by the conflicting opinions of lower Federal Courts, such as in the instant case. For here we are dealing with a taxpayer who did not himself at any time receive any money or any bargain sale, and was not one dollar richer at the end of the transactions in question than he was before they began, but what transpired was simply that the multi-wall bag business in question was purchased from the Atlanta Fulton corporation by five of the Taxpayer's corporations and and then sold *at cost* to another corporation owned by Taxpayer, after which the business was then sold at a profit to a company not owned by Taxpayer, namely, Westvaco. This is not a case where any business was sold at cost on a bargain basis to the Taxpayer himself, who then made a sale at a profit, but is instead a case where the Taxpayer, if he is ever to receive the benefit of any profit to himself individually must of course inevitably pay a tax on such money when he receives it out of the corporations in question.

Therefore, a legitimate question of fact was raised in this case as to whether or not the five corporations originally owning title to the multi-wall bag business were simply acting as agents for the corporation to which such companies sold

all the business at cost within a matter of only about six weeks. Put another way, and more directly put in the language of *Palmer*, a question was directly raised, factually, as to the intent of the transferor corporations to distribute corporate earnings to a stockholder, and secondly, a question was raised as to the intent of the transferor corporations to acquire and hold title initially only as agents or accommodation purchasers for the corporation to which title was then transferred at cost, and thirdly a question was raised as to the intent of the transferor corporations in transferring the stock in question as to whether or not such transfer was accompanied by a valid business purpose of such transferor corporations.

All of these important questions of fact were required to be resolved under the decision of this Honorable Court in *Palmer*, and were requested by Petitioner in his requested jury instruction and requested special issue prior to submission of the Court's Charge to the jury.

So many opinions of Lower Courts suggest baldly that "intention" and "motive" have become totally irrelevant, to-wit: *Helvering v. Gordon*, 87 F. 2d 663, 666 (C.A. 8, 1937); *Wiseman v. United States*, 371 F. 2d 816, 818 (C.A. 1, 1967); *Commissioner v. Riss*, 374 F. 2d 161, 167 (C.A. 8, 1967); *Gibbs v. Tomlinson*, 362 F. 2d 394, 397 (C.A. 5, 1966); *Hash v. Commissioner*, 273 F. 2d 248 (C.A. 4, 1959); *Sachs v. Commisioner*, 277 F. 2d 879 (C.A. 1960); *Dellinger v. Commissioner*, 32 T.C. 1178 (1959).

In view of all the hammering-away of the *Palmer* principle by these decisions of Lower Courts, it is highly important

that this Honorable Court reaffirm the meaning and intent of its earlier decision. Surely in a case like this, and in countless others like it, it cannot be contended that it makes no difference whether the corporations initially acquiring title herein were acting *merely as agents and accommodation purchasers* or not. *To hold otherwise would be to give effect merely to form and not to substance.* Thus, when some of these Lower Courts say, as they are so wont to say, that whether a transfer or sale of property to a stockholder (and here it was not to a stockholder but to another corporation) constitutes a dividend to him for tax purposes is not controlled by the *intent* of the parties to the transaction but depends upon the circumstances and actual *effect* of the particular transaction, such language is meaningless unless the Lower Courts are attempting to say merely that the "expressed" intent of the transferor corporation is not determinative of the tax consequences in question. But always the proper statement of the principle of law here involved must be, as stated in *Palmer*, that it is at least necessary for there to be *some showing* that the transaction involved is in *purpose or effect used or intended* as an implement for the distribution of corporate earnings to stockholders, a showing not made in the instant case and deliberately kept from the jury by the rulings of the Trial Court on Petitioner's requested instruction and special issue, which erroneous action was then later affirmed by the Appellate Court below.

CONCLUSION

For the foregoing reasons, this Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

WHITE, MCELROY & WHITE,

By B. Thomas McElroy

B. THOMAS MCELROY
2505 Republic National Bank Tower,
Dallas, Texas 75201,
Attorneys for Petitioner.

CERTIFICATE OF SERVICE

It is hereby certified that service of this Petition has been made on opposing counsel by mailing two copies thereof on this 12 day of March, 1971, in an envelope with postage prepaid, properly addressed to him as follows:

Solicitor General of the United States
Department of Justice
Washington, D. C.

B. Thomas McElroy

B. Thomas McElroy

APPENDIX A

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 29227

C. A. SAMMONS, Individually and as Independent Executor of the Estate of ROSINE S. SAMMONS, Deceased,

Plaintiff-Appellant,

versus

UNITED STATES OF AMERICA,

Defendant-Appellee.

Appeal from the United States District Court for the Northern District of Texas

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(November 4, 1970)

Before GEWIN, MORGAN and ADAMS*, Circuit Judges.

MORGAN, Circuit Judge: In this federal income tax case appellant-taxpayer claims a refund for taxes paid on an alleged constructive dividend which arose when stock was transferred between corporations either owned outright or controlled by the taxpayer. The

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*Of the Third Circuit, sitting by designation.

jury below found that the stock was transferred at a price well below fair market value, and the trial judge entered judgment against the taxpayer. We affirm.

In December of 1957, Sammons, the taxpayer in this contest, became interested in purchasing a multi-wall bag and paper business for sale by Fulton Bag and Cotton Mills Company ("Atlanta Fulton"). As controlling shareholder of several large corporations, Sammons used a rather complicated plan which resulted in his acquisition on January 2, 1958, of the two factories comprising the bag manufacturing operation. This plan may be outlined as follows: American Republic Life Insurance Company, a corporation indirectly controlled by Sammons, purchased the fixed assets while the other assets of the bag business were acquired by Fulton Bag and Products Company ("Texas Fulton") which had as its sole owners five corporations controlled by Sammons.[1] The fixed assets were then leased by American Republic to Texas Fulton which commenced the operation of the multi-wall bag business previously operated by Atlanta Fulton.

On February 11, 1958, the five Sammons' corporations sold their Texas Fulton stock at cost to another Sammons' corporation, Fidelity National Life Insurance Company. At the trial below, Sammons stated that he originally acquired the bag business through the five corporations and then later transferred the business to Fidelity for two principal reasons: First,

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[1]The five corporations owning Texas Fulton were American Republic Life Insurance Company, Reserve Life Insurance Company, American Security Life Insurance Company, Dearborn Stove Company, and Bennett Printing Company.

due to the tight money situation at the time of the initial purchase, Fidelity was unable to come up with enough capital to finance the sale, whereas, the five other corporations in combination easily raised the money. Secondly, the bag business was not retained by the five corporations because Sammons wanted to enlarge Fidelity by allowing it to acquire profitable investments and thus provide a place for executive employees in other parts of the organization who were interested in managing a small and yet expanding corporation.

Fidelity held its investment until April 2, 1958, when, after lengthy negotiations, the Texas Fulton stock was sold to West Virginia Pulp and Paper Company (Westvaco) for cost plus $556,000 profit. Westvaco purchased the bag business because it had recently developed a technological breakthrough, the Clupac process, whereby stretchable paper could be produced and then made into elastic paper bags. Westvaco hoped to create a consumer demand for their product and thereby force other paper companies to buy the Clupac process on a licensing basis.

Simply stated, the multi-wall bag business progressed through three separate transactions within a time period of approximately four months: The business was purchased from Atlanta Fulton by the five Sammons' corporations; it was then sold at cost to another Sammons' corporation; and, thirdly, the business was sold at a profit to Westvaco, a company outside the Sammons corporate empire.

The jury's finding, upheld by the district court, was that Fidelity received a bargain purchase from its five brother corporations in that the fair market value of Texas Fulton stock was greater than the amount given by Fidelity. Specifically, the jury concluded that when Sammons caused the stock to be transferred out of the five corporations and into Fidelity, it was worth $500,000 more than Fidelity paid, leaving the taxpayer, Sammons, liable for taxes on this sum as a constructive dividend.

Under Sections 316(a) and 301(c) (1)[2] of the Internal Revenue Code of 1954, dividends to the shareholder must be included in gross income. The dividend may take the form of cash or it may be constructive so that when a shareholder receives property from the corporation at less than fair market value the difference between this sum and the price paid for the property is included in gross income because "such a sale, if for substantially less than the value of the property sold, may be as effective a means of distributing profits among stockholders as the formal declaration of a dividend". *Palmer* v. *Commissioner*, 1937, 302 U.S. 63, 69.

Neither does the dividend escape taxation simply because it fails to pass through the hands of the particular taxpayer when, as in the instant case, the divi-

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[2]Under Section 316(a), a dividend is defined as "any distribution of property made by a corporation to its shareholders .... out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits".
Section 301(c) (1) then provides that "That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income".

dend is diverted at the behest of the shareholder into the hands of others. *Biltmore Homes, Inc.* v. *Commissioner*, 4 Cir., 1961, 288 F. 2d 336, cert. den. 386 U.S. 825 (1961); *Worcester* v. *Commissioner*, 1 Cir., 1966, 370 F. 2d 713.

In this appeal the main contention advanced by the taxpayer is that the government did not present sufficient evidence from which a jury could make a valid determination as to the fair market value of the Texas Fulton stock. Attention is drawn to the fact that only negotiations were taking place between Sammons and Westvaco at the time the stock was transferred to Fidelity which, taxpayer asserts, renders valueless the testimony by Westvaco's officer that Sammons had made an offer to sell for cost plus $500,000. The evidence that Westvaco actually did buy Texas Fulton for cost plus $556,000 is insufficient according to appellant because this deal was not consummated until 49 days after Fidelity acquired the stock at cost, and also because Westvaco was a compulsive buyer rather than a willing buyer due to its desire to find an outlet for the Clupac process.

While the taxpayer has pointed out some apparent reasons for discounting the evidence of fair market value offered by the government, this court must exercise great care lest we go beyond our authority and intrude upon that part of the judicial process which the Constitution[3] has reserved for the jury. This circuit is replete with cases which protect the jury verdict

[3]United States Constitution, Amendment VII.

from undue judicial scrutiny[4] and only recently we reaffirmed the long standing test that must be followed when the appeal challenges the sufficiency of the evidence:

> "We have said that if there is no evidentiary basis for the jury's verdict it cannot be permitted to stand, and that the standard for reviewing a jury verdict is whether the state of proof is such that reasonable and impartial minds could reach the conclusion the jury expressed in its verdict. The jury is, of course, the traditional finder of facts, and its verdict must stand unless appellant can show that there is no substantial evidence to support it, considering the evidence in the light most favorable to appellees, and clothing it with all reasonable inferences to be deducted therefrom. It is not the function of the appellate court, however, to weigh conflicting evidence, judge the credibility of witnesses and arrive at a conclusion opposite from the one reached by the jury, where there is a reasonable basis in the record for the jury's verdict." *Liberty Mutual Insurance Co.* v. *Falgoust*, 5 Cir., 1967, 386 F. 2d 248, 253.

See also *Boeing Company* v. *Shipman*, 5 Cir., 1969, 411 F. 2d 365.

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[4]*First National Bank of Melbourne v. Sogaard and Debo, Inc.*, 5 Cir., 1970, 406 F.2d 1128; *Gulf Oil Corporation v. Griffith*, 5 Cir., 1964, 330 F.2d 729. *Jones & Laughlin Steel Corporation* v. *Matherne*, 5 Cir., 1965, 348 F. 2d 394.

Applying these standards and considering the evidence in the light most favorable to the government, it is obvious from a review of the record that there was more than ample evidence upon which reasonable and impartial minds might conclude that the fair market value of Texas Fulton stock was indeed $500,000 greater than the amount paid by Fidelity. The testimony reveals that negotiations for the sale of the bag business began on February 9, 1959, when Mr. Birkelund, a director of Westvaco, met Mr. Sammons in Chicago and was informed by Sammons that the bag manufacturing operation could be purchased for cost plus one-half million dollars. This meeting occurred before the transfer at cost of the Texas Fulton stock to Fidelity and the negotiations continued until a final agreement was reached on April 2, 1958, whereby Westvaco did in fact pay Sammons according to the terms of the initial Chicago meeting.

The taxpayer replies to these facts by citing cases[5] for the proposition that mere offers of purchase or sale do not constitute evidence of probative force as to fair market value. The record, however, shows that the jury had more than mere offers upon which to base their verdict. There were continuous negotiations between Sammons and Westvaco resulting in a contract which coincided precisely with the terms set by the taxpayer before he transferred the stock from one segment of his corporate organization to another. Looking to the testimony concerning the negotiations both

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[5] *Sharp* v. *United States*, 1903, 191 U.S. 341; *St. Joe Paper Co.* v. *United States*, 5 Cir., 1946, 155 F. 2d 93; *United States* v. *Smith*, 5 Cir., 1966, 355 F. 2d 807.

before and after the sale to Fidelity and to the fact that a contract was signed four months later embodying the basic terms of such negotiations, we find the record easily sustains the jury's conclusion that fair market value was the amount stated by the taxpayer himself in his original discussion with Westvaco in Chicago.

As to the contention that the Clupac process which Westvaco desired to promote gave it a special need for a paper bag plant and thus rendered the purchaser a compulsive buyer not worthy of testifying on the question of fair market value, we find little merit. Several cases are referred to which hold that the purchaser was a compulsive buyer because he was under a statutory duty to purchase[6] or because the desire for a tax saving motivated the higher than normal price[7] or because the purchase was made at a foreclosure sale.[8] However, the degree of pressure on the buyer in this line of cases differs markedly from that which motivated Westvaco. Westvaco simply had a valid business reason for acquiring a bag plant and there is no evidence in the record that the company was forced to buy from Sammons and that it could not have gone elsewhere and purchased a similar factory. Stated differently, the only force compelling the buyer in this case was a desire on their part to make a profit, and we can find no decision where such a factor, standing alone, has excluded testimony on fair market value.

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[6]*Howell* v. *United States*, 7 Cir., 1969, 414 F. 2d 45.
[7]*Goldstein* v. *Commissioner*, 9 Cir., 1962, 289 F. 2d 562.
[8]*Helvering* v. *New President Corporation*, 8 Cir., 1941, 122 F. 2d 92.

The taxpayer further contends that under *Palmer* v. *Commissioner,* supra, he did not receive a constructive dividend because the stock sale was not intended as a distribution of earnings to the shareholder. This is an erroneous view of *Palmer* for intent to distribute corporate earnings is not a universal requirement for a finding that a constructive dividend has been paid. *Waldheim* v. *Commissioner*, 7 Cir., 1957, 241 F. 2d 1; cf. *Commissioner* v. *Gordon,* 1968, 391 U.S. 83, where the Supreme Court recently decided that a constructive dividend existed and yet made no mention of an intent to distribute earnings.

We have considered the taxpayer's claim that Birkelund's (Westvaco director) oral testimony concerning the content of two letters should have been excluded as hearsay and, without deciding the hearsay issue, we reject this claim. The taxpayer has not demonstrated and from a search of the record we are unable to conclude that the testimony was other than harmless error even if it was in fact erroneously admitted.

We also reject the taxpayer's contention that his motion for directed verdict should have been granted on the ground that the five corporations were mere agents of Fidelity. The existence of an agency relationship was not presented to the trier of fact[9] and the

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[9]As both parties concede, the agency relationship is a question of fact which, in the absence of a requested instruction on this matter in the trial court or a finding by this court that reasonable minds could not differ as to the existence of the relationship, may not be raised on appeal. Cf. *Martin* v. *United States,* 5 Cir., 1968, 393 F. 2d 92; *Pan-American Life Insurance Co.* v. *Alvarez,* 5 Cir., 1967, 374 F. 2d 92.

state of the record is not such as would permit a finding on our part that reasonable minds could not have differed on this factual matter.

In conclusion, we hold that Mr. Sammons received a constructive dividend when he moved the paper bag business between wholly-owned or controlled corporate entities at a price which the jury reasonably concluded to be one-half million dollars below fair market value. In reality then, the taxpayer took money from his five corporations and placed it in a sixth. It is of little consequence that he personally received no money from the transaction, for it is the power to dispose of income and the exercise of that power that determines whether taxable income has been received. *Helvering* v. *Horst*, 1940, 311 U.S. 112; *Floyd* v. *Scofield*, 5 Cir., 1952, 193 F. 2d 594.

AFFIRMED.

Adm. Office, U.S. Courts—Scofields' Quality Printers, Inc., N. O., La.

In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 1471

C. A. SAMMONS, Individually and as Independent Executor of the Estate of ROSINE S. SAMMONS, Deceased, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The district court filed no opinion, basing its judgment (Pet. App. B 1-B 2) upon the jury's answers to special interrogatories. The opinion of the court of appeals (Pet. App. A 1-10) is reported at 433 F. 2d 728.

JURISDICTION

The judgment of the court of appeals was entered on November 4, 1970 (Pet. App. B 3-B 4). A petition for rehearing was denied on December 15, 1970 (Pet. App. B 6). The petition for a writ of certiorari was filed on

March 15, 1971. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, on the record, both courts below correctly held that petitioner constructively received a dividend where, as the jury found, assets were transferred from one to another of the corporations controlled by petitioner for $500,000 less than fair market value.

STATUTES INVOLVED

The statutory provisions involved are set forth in the Appendix, *infra*, pp. 9-10.

STATEMENT

Shortly before January, 1958, five corporations which petitioner controlled directly or indirectly,[1] and which, in turn, owned all of the stock of Fulton Bag and Products Company ("Texas Fulton"), contributed $700,000 to the capital of Texas Fulton. It is undisputed that $700,000 was the cost basis of the five corporations in Texas Fulton's stock, Texas Fulton having previously been a dormant corporation. On January 2 and 3, 1958, Texas Fulton and American Republic Life Insurance Company ("American Republic"), one of the five corporations that owned the Texas Fulton stock, acquired a multi-wall paper bag business, American

[1] Petitioner directly controlled certain of the corporations involved through stock ownership in those corporations. He indirectly controlled other of the corporations involved through ownership of the controlling stock of their parent corporations.

Republic acquiring the fixed assets of that business, and Texas Fulton the remaining assets. Texas Fulton immediately leased the fixed assets from American Republic and commenced its multi-wall bag operations. (Pet. App. A 2; R. 41-42, 252, 265-266, 289.)[2]

At the beginning of February, 1958, the West Virginia Pulp and Paper Company ("Westvaco") began negotiations with petitioner, initially through officers of Texas Fulton, with a view to purchasing the multi-wall bag business (R. 225, 231, 235). On February 7, petitioner advised Westvaco that his price was his original cost plus $500,000 plus expenses of sale (R. 205-206, 209, 222-223). Further negotiations between the parties took place on February 9, 11, 14 and 18, with Westvaco indicating on February 18 that it was willing to close along the lines of petitioner's initial asking price (R. 205, 209, 211, 215-219, 231-232).

Meanwhile, on some date between February 10 and February 19, the five corporations owning the Texas Fulton stock sold it at cost ($700,000) to Fidelity National Life Insurance Company ("Fidelity National"), another corporation controlled by petitioner. On February 19, Fidelity National borrowed the purchase money from a bank pursuant to a loan application of the same date. (Pet. App. A 2; R. 265-266, 278-279, 313-315, 329.)

On March 8, 1958, Westvaco contracted to purchase the Texas Fulton stock from Fidelity National for the latter's cost of the stock ($700,000) plus $500,000 with

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[2] "R." references are to the record appendix in the court of appeals which we have lodged with the Clerk of this Court.

certain minor adjustments. American Republic thereupon transferred the fixed assets to Texas Fulton for its cost, and the Texas Fulton stock was then transferred to Westvaco on April 2, 1958, under the terms of the March 8 contract. (Pet. App. A 3; R. 49, 51, 338.)

At the conclusion of the trial below, in answer to special interrogatories, the jury returned a verdict that the stock of Texas Fulton and the fixed assets of American Republic were transferred to Fidelity National for $500,000 less than the fair market value thereof (Pet. App. B 1). As appears from the court's charge to the jury (R. 400-405), the judgment on the verdict (Pet. App. A 2) reflected treatment of the $500,000 spread as a constructive dividend to petitioner, since the transfers were made at his behest and for his benefit by giving Fidelity National, his corporation, an asset—the Texas Fulton stock—worth $500,000 more than Fidelity National paid for it.

ARGUMENT

The decision below is correct. There is no conflict or other basis for further review.

1. Sections 301(c)(1) and 316(a) of the Internal Revenue Code (Appendix, *infra*, pp. 9-10), provide that a distribution to a stockholder out of a corporation's earnings and profits constitutes a dividend, and that such a distribution is includable in the stockholder's gross income. But it has long been settled that there may be a constructive dividend to a stockholder even though there is no formal declaration and distribution of a dividend. The test is whether there is a diminution

in the earnings and profits of a corporation which inures to the benefit of a stockholder, in one form or another. Familiar examples of constructive dividend situations are cases in which there is a transfer of corporate assets to a stockholder for a price which is less than the property's fair market value (*Waldheim* v. *Commissioner,* 244 F. 2d 1 (C.A. 7)), or in which a corporation pays a stockholder's debt to a third party (*Sachs* v. *Commissioner,* 277 F. 2d 879 (C.A. 8), certiorari denied, 364 U.S. 833; *Wall* v. *United States,* 164 F. 2d 462 (C.A. 4)).

By the same token, the courts have held that a stockholder who causes a transfer of assets from one to another of the corporations he controls, for an inadequate consideration, receives dividend income to the extent that the transferor's earnings and profits are diminished. See, *e.g., Biltmore Homes, Inc.* v. *Commissioner,* 288 F. 2d 336 (C.A. 4), certiorari denied, 368 U.S. 825; *Worcester* v. *Commissioner,* 370 F. 2d 713 (C.A. 1); *Lonsdale* v. *Commissioner,* 32 F. 2d 537 (C.A. 8), certiorari denied *sub nom. Lonsdale* v. *Lucas,* 280 U.S. 575. In these situations, the stockholder is economically benefited by the enrichment of his second corporation, just as he is by the payment of a debt which he owes to a third party. Moreover, taxing the diverted earnings to him is consistent with the "assignment of income" cases, in which corporate earnings diverted by a stockholder to a third party are taxable to him even though he receives no direct economic benefit, because he has exercised the power to dispose of the income. See *Helvering* v. *Horst,* 311 U.S. 112.

Here, petitioner caused five of his corporations to sell assets at cost to Fidelity National, another of his corporations, at the very time he was successfully negotiating a sale of those assets to Westvaco for cost plus $500,000. Within weeks after the transfer to Fidelity National, the sale to Westvaco at cost plus $500,000 was consummated. Under these circumstances, the jury was surely warranted in finding that Fidelity National acquired the assets at $500,000 less than fair market value, and the courts below quite properly ruled that the $500,000 diverted from the earnings and profits of the five transferor corporations constituted a constructive dividend to petitioner. Compare *Commissioner* v. *Court Holding Company,* 324 U.S. 331.

2. Petitioner erroneously asserts conflict with *Palmer* v. *Commissioner,* 302 U.S. 63 (Pet. 5-8). In *Palmer* this Court held that there was adequate consideration for a distribution of rights to shareholders and, consequently, that there was no constructive dividend. *Palmer* has no application where, as here, the consideration for a transfer of corporate assets is less than the relevant fair market value. The Court went on to say by way of dictum in *Palmer* (302 U.S. at 70) that a distribution of corporate assets to stockholders could only give rise to a dividend if there was "some showing that the transaction is in purpose *or effect* used as an implement for the distribution of corporate earnings to stockholders." (Emphasis supplied.)

The quoted dictum cannot be read to mean that a diversion of corporate assets does not constitute a dividend unless the stockholder who diverts the assets

intends a taxable dividend. Properly interpreted, the Court's reference to "purpose or effect" is to the consequences of a taxpayer's actions and not his motives.[3] This is made clear by the Court's denials of petitions for certiorari in several cases, cited above, that are squarely in accord with the decision below, and by the Court's recent decision in *Commissioner* v. *Gordon,* 391 U.S. 83. The Court there concluded, without mentioning purpose or intention, that (pp. 89-90)—

> it is clear that when a corporation sells corporate property to stockholders *or their assignees* at less than its fair market value, thus diminishing the net worth of the corporation, it is engaging in a "distribution of property" as that term is used in § 316. Such a sale thus results in a dividend to shareholders unless some specific exception or qualification [enumerated in the statute] applies. * * * [Emphasis supplied.]

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[3] Petitioner's argument (Pet. 6-7) that he did not intend to divert corporate earnings for his own benefit must, in any event, fail. The claim that the five transferor corporations intended to hold the stock merely as agent for Fidelity National was not properly raised in the trial court, and the court of appeals found no justification in the record for passing on it (Pet. App. A 9-10). The further claim was that the transactions in question were intended to benefit the transferor corporations. But petitioner failed to convince either of the lower courts that there was an adequate justification or countervailing benefit, from the standpoint of the transferor corporations, for relinquishing the $500,000 profit available from Westvaco and channeled to Fidelity National.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

JOHNNIE M. WALTERS,
Assistant Attorney General.

GRANT W. WIPRUD,
JOHN A. TOWNSEND,
Attorneys.

APRIL 1971.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 301. DISTRIBUTIONS OF PROPERTY.

(a) *In General.*—Except as otherwise provided in this chapter, a distribution of property (as defined in section 317(a)) made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in subsection (c).

* * * * *

(c) *Amount Taxable.*—In the case of a distribution to which subsection (a) applies—

(1) *Amount constituting dividend.*—That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income.

* * * * *

SEC. 316. DIVIDEND DEFINED.

(a) *General Rule.*—For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—

(1) out of its earnings and profits accumulated after February 28, 1913, or

(2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the

earnings and profits at the time the distribution was made.

Except as otherwise provided in this subtitle, every distribution is made out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits. To the extent that any distribution is, under any provision of this subchapter, treated as a distribution of property to which section 301 applies, such distribution shall be treated as a distribution of property for purposes of this subsection.

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